BILL # SB 1263 **TITLE:** corporate tax credit; tuition organizations

SPONSOR: Anderson **STATUS:** Senate Engrossed

REQUESTED BY: Senate **PREPARED BY:** Steve Schimpp

	FISCAL YEAR		
	2003	**2004**	**2005**
EXPENDITURES			
General Fund	$-0-	$-0-	See Below
REVENUES			
General Fund – Corporate Income Tax	$-0-	$-0-	See Below

FISCAL ANALYSIS

Description

SB 1263 would allow Arizona corporations to claim a tax credit for contributions made to School Tuition Organizations (STO's) under certain conditions. Corporate contributions to STO's under the bill would be used to provide scholarships to pupils who qualify for "free or reduced price lunches" under the National School Lunch and Child Nutrition Acts. This would include households with incomes below 180% of the Federal Poverty Level (FPL), which currently equals about $32,600 per year for a family of 4.

Estimated Impact

The Senate Engrossed version of SB 1263 would have two areas of possible fiscal impact: 1) the new tax credit would reduce state revenues from the corporate income tax by up to $10 million starting in FY 2005, and 2) new scholarships that would be awarded under the bill would reduce Basic State Aid costs if current public school students transferred to private schools because of the bill. The bill would have a net state cost if corporate income tax revenues decreased more than Basic State Aid costs, but would yield a savings if the opposite occurred.

Analysis

The bill contains a number of restrictions that would reduce its potential for having a net state cost (see Attachment 1). We cannot determine for sure that the bill would have no state cost, however, because even under current law it is possible that some low-income students transfer from public to private schools each year. Such students ("natural transfers") would qualify for scholarships under the bill, but would not result in a new state savings because they would transfer out of the public schools even without the bill. The number of natural transfers could be small, since families that are at or below 180% of FPL have less disposable income with which to pay private school tuition. We do not know the level of low-income natural transfers to assume in this analysis, however, because data on natural transfers by income level do not exist.

The bill would not generate Basic State Aid savings if students receiving scholarships came from "zero-aid" districts. There are about 22,000 such students in Arizona.

<u>Sample Scenarios</u>

Describing some sample scenarios could be helpful in demonstrating complexities in estimating the bill's fiscal impact. In "Scenario 1," we assume that corporate contributions would equal $2 million in FY 2005. This low level, relative to the $10 million cap, could occur due to the complexity of the program's administrative requirements. In "Scenario 2," we assume

(Continued)

Analysis (Cont'd)

that corporate contributions would equal $10 million in FY 2005, which would be the maximum amount allowed under the bill that year. In addition, "Scenario 3" estimates what would happen if $10 million in corporate contributions were received and if 20% of scholarships were awarded to "natural transfers."

Under all scenarios we assume an average scholarship amount of $2,500, which would provide 800 scholarships under "Scenario 1" ($2 million / $2,500 per scholarship = 800 scholarships) and 4,000 under "Scenarios 2 & 3" ($10 million / $2,500 per scholarship = 4,000 scholarships). The bill actually would allow STO's to provide scholarships of any amount up to about $3,200, but we assume under both scenarios that STO's would want to maximize the number of pupils receiving scholarships while covering most or all of tuition costs for eligible (less than 180% of FPL) pupils.

"Scenario 1" would be at least revenue neutral if the bill generated $2 million in Basic State Aid savings in order to offset a $2 million reduction in corporate income tax collections. At a savings rate of $4,500 per transferred pupil, 444 students who otherwise would not have left public school ("tax credit transfers") would have to move to private schools in order to generate $2 million in offsetting savings (444 students X $4,500 Basic State Aid savings per pupil = $2 million). Therefore no more than 356 natural transfers could occur under Scenario 1 in order for the bill to be revenue neutral (800 available scholarships – 444 minimum for tax credit transfers = 356 available for natural transfers).

Under "Scenario 2" there would be $10 million in corporate donations, so the bill would have to generate $10 million in Basic State Aid savings in order to become at least revenue neutral. This would require 2,222 tax credit transfers to leave public schools (2,222 students X $4,500 Basic State Aid savings per pupil = $10 million), which would mean that up to 1,778 natural transfers could receive scholarships under this scenario (4,000 available scholarships – 2,222 minimum for tax credit transfers = 1,778 available for natural transfers).

In "Scenario 3," 80% of the scholarships (3,200 of 4,000) would go to "tax credit transfers." In this circumstance, there would be Basic State Aid savings of about $14.4 million. This savings would be partially offset by $10 million in corporate tax credits, for a net General Fund gain of $4.4 million.

As noted above, we cannot predict the number of "natural transfers" versus "tax credit transfers" that would occur under the bill. The scenarios, however, demonstrate that the bill is more likely to be at least revenue neutral if corporate donations are "high" versus "low." This is because higher donations levels allow more scholarships to be awarded, which increases the potential for "tax credit transfers" (transfers that result in a state savings) to exceed "natural transfers" (transfers that would result in a state cost) and produce a net state savings.

We would speculate that a low level of scholarships may cover more "natural transfers" than "tax credit transfers." This is because each year there may be a core number of parents who will transfer their children from public to private schools without an STO scholarship. The STO's, however, may still end up awarding scholarships to these students thereby generating no real savings to the General Fund. As the number of scholarships grows, however, it is more likely that tax credit transfers can outpace the natural transfers.

At a "high" level of contributions and "low" number of natural transfers, "Scenario 3" demonstrates that the bill would generate savings.

Local Government Impact

The bill requires the Arizona Department of Education to subtract "scholarship" pupils from the student counts of school districts from which they transfer. This would not affect Basic State Aid (BSA) funding for growing school districts, since their BSA funding is paid based on their *current* year Average Daily Membership (ADM) counts and pupils who transferred out of public school under the bill would not be included in those counts anyway. Non-growing school districts, however, receive BSA funding based on their *prior* year ADM counts. Subtracting transferred students from those counts therefore would reduce their BSA funding in the current year. We cannot estimate the loss of funding to non-growing school districts under the bill because we cannot predict the number or "mix" of scholarship pupils that would come from growing versus non-growing school districts.

Growing districts potentially could receive less funding for new school construction from the School Facilities Board (SFB) under the bill, if it reduced their ADM counts enough to affect their need for new school buildings. We cannot predict the number of pupils who would leave growing districts under the bill, however, and therefore cannot predict whether any of them would receive less SFB new construction money under it.

(Attachment 1)

Cost-Minimizing Assumptions for SB 1263

1. The bill does not take effect until Tax Year 2004 (FY 2005).
2. Corporate contributions that are eligible for a tax credit are capped at $10 M in FY05, $20 M in FY06, $30 M in FY07, $40 M in FY08 and $50 M in FY09.
3. Corporate contributions may only be received between January 1 and July 15 of a contribution year.
4. Corporations are required to receive pre-approval from the Arizona Department of Revenue prior to making an STO contribution, in order to make sure that the contribution cap for the year has not yet been reached.
5. Corporate donations not used for scholarships by August 30 of each year must be refunded to the donor and are not eligible for a tax credit.
6. STO’s must award scholarships on a full-year basis only and prior to the start of a school year.
7. Individual scholarships are limited to 60% of the per pupil expenditure amount reported by the superintendent of public instruction pursuant to A.R.S. § 15-255.
8. STO’s may award scholarships only to pupils who were full-time ADM pupils in a school district during the prior fiscal year, or who received a scholarship from the corporate funded program in the prior year.
9. STO’s may award scholarships only to pupils who qualify for free or reduced price lunches under the National School Lunch and Child Nutrition Acts.
10. STO’s would be required to notify ADE each time they issued a scholarship under the program, including the name of the scholarship recipient and the name of the school district or districts that the pupil attended during the prior school year.
11. After STO notification to ADE, ADE would be required to immediately reduce the student count of the school district where the child was enrolled during the prior school year so that the district would not be eligible in the “current year” to receive Basic State Aid funding for that pupil (since non-growing districts receive BSA funding based on their “prior year” ADM counts). This would reduce funding to non-growing school districts, although those losses would be somewhat reduced if a school district lost more than 5% of its student count for all reasons combined (including scholarship transfers). If so, the “Rapid Decline” formula in A.R.S. § 15-942 would partially compensate the district for its rapid loss of pupils.
12. STO’s must use 100% of corporate donations for scholarships. None may be used for administrative costs.
13. STO’s must provide donors with documentation verifying that their donations were used to provide scholarships for eligible pupils, and a corporation must submit a copy of this documentation with its annual tax return.
14. If a scholarship recipient leaves a private school partway through a school year, the private school must refund to the relevant STO a prorated share of the scholarship monies and the STO must refund that amount of money to a corporate donor and reduce its eligibility for a tax credit by the same amount.